

Internal Revenue Service

Department of the Treasury

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Date:
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LEGEND:

A =
B =
Company =
M=
Trust=
State=
Year=

Dear _____ :

This letter is in response to the letter dated March 22, 2001, submitted on behalf of Company, requesting the following rulings:

- (1) That the Trust established in the reorganization plan qualifies as a qualified settlement fund within the meaning of section 468B of the Internal Revenue Code and the regulations thereunder. The Trust will be treated as a separate tax entity;
- (2) That the Trust will be subject to tax on its modified gross income as defined in section 1.468B-2(a) of the Income Tax Regulations, at a rate equal to the maximum rate in effect for that taxable year under section 1(e) of the Internal Revenue Code;
- (3) That the transfer of Company's stock into the Trust and the transfer of cash and other assets into the Trust on behalf of Company to resolve the liability that the Trust was created to assume, will not constitute gross income to the Trust; and
- (4) That Company will be entitled to deduct transfers made to the Trust, in the year of each payment, to the extent that they do not represent settlements from insurance claims that are excludable from gross income.

FACTS

Based upon the facts submitted and the representations made by the taxpayer, the taxpayer was originally two separate entities, A and B. A and B were small manufacturers of certain specialty products. Before Year, a small portion of taxpayer's business involved the manufacture of various items containing M. The items were used by _____ . As a result of manufacturing items containing M, A

and B were named as defendants in a large number personal injury lawsuits seeking damages for death or injury due to M-related diseases. Taxpayer uses an method of accounting.

A and B each filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code. The two cases were merged. The Bankruptcy Court issued an order confirming a plan of reorganization (hereinafter referred to as the Plan). The Plan, as approved by Bankruptcy Court

was cancelled, new stock was issued for Company and all the stock of Company was transferred to the Trust. Company operates the existing business free of any further M related claims.

The Plan expressly provides that the Trust was established to assume and pay all of Company's M-related liabilities. The Plan required Company to transfer assets to Trust to be used to pay such liabilities. The Plan relieves Company of all M-related liability in exchange for such transfer. According to the court's confirmation order, the Trust was established under the laws of State. The Trust will remain under the continuing jurisdiction of the bankruptcy court. The Trust was funded with the following:

1. 100% of Company's stock. Company's stock is not publicly traded.
2. The proceeds from Company products liability insurance policies.
3. An assignment of all M related rights or causes of action that Company may have against another entity.
4. Excess cash not needed to operate Company.

The Trust is managed by an Independent Trustee. The Trust agreement provides for termination following the payment of all known M-related liabilities. Any remaining Trust assets will then be transferred to a section 501(c)(3)/170(b) organization not related to either Company or the Trustees.

REQUESTED RULING 1

Section 468B(g) of the Internal Revenue Code provides, in part, that nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. Pursuant to the authority granted to the Secretary under section 468B(g) of the Code, the Secretary has published sections 1.468B-1 through 1.468B-5 of the Income Tax Regulations relating to qualified settlement funds.

Section 1.468B-1(c) of the Income Tax Regulations provides that a fund, account, or trust is a qualified settlement fund if it meets the following three requirements:

- (1) It is established pursuant to an order of, or it is approved

by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continued jurisdiction of that governmental authority;

(2) It is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to at least one claim asserting liability (i) under the Comprehensive Environmental Response Compensation and Liability Act of 1980, as amended, 42 U.S.C. 9601 et seq, or (ii) arising out of a tort, breach of contract, or violation of law; or (iii) designated by the Commissioner in a revenue ruling or revenue procedure; and

(3) The fund, account, or trust is a trust under applicable state law, or its assets are otherwise segregated from other assets of the transferor (and related persons).

In this case, the Trust satisfies the three requirements outlined in the regulations for qualified settlement fund treatment. First, the Plan, which contains provisions for the establishment of the Trust, was approved by the court and the Trust will be subject to the continuing jurisdiction of the court. Second, the Trust was established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from a related series of events that have occurred and have given rise to at least one claim arising out of a tort, breach of contract, or violation of law. Third, the Trust was formed and is administered in accordance with State law.

REQUESTED RULING 2

Section 1.468B-2(a) provides that a qualified settlement fund is a United States person and is subject to tax on its modified gross income for any taxable year at a rate equal to the maximum rate in effect for that taxable year under section 1(e).

Because the Trust in this case is a qualified settlement fund, it will be subject to tax on its modified gross income for any taxable year at a rate equal to the maximum rate in effect for that taxable year under section 1(e).

REQUESTED RULING 3

Section 1.468B-2(b) of the Income Tax Regulations defines the “modified gross income” of a qualified settlement fund, generally, as its gross income, as defined in

section 61 of the Code. It specifically provides, however, that:

In general, amounts transferred to the qualified settlement fund by, or on behalf of, a transferor to resolve or satisfy a liability for which the fund is established are excluded from gross income. However, dividends on stock of a transferor (or related person), interest on debt of a transferor (or a related person), and payments in compensation for late or delayed transfers, are not excluded from gross income.

In this case, the Trust is a qualified settlement fund that was established, pursuant to the court's Plan, to assume and pay Company's M-related liabilities. Accordingly, transfers made by, or on behalf of, Company to resolve such liabilities will not constitute gross income to the Trust.

REQUESTED RULING 4

Section 162(a) of the Code provides, in relevant part, that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Furthermore, even though a particular taxpayer may incur an expense only once in the lifetime of its business, the expense may qualify as ordinary and necessary if it is appropriate and helpful in carrying on that business, is commonly and frequently incurred in the type of business conducted by the taxpayer, and is not a capital expenditure. *Commissioner v. Tellier*, 383 U.S. 687 (1966); *Deputy v. du Pont*, 308 U.S. 488 (1940).

Section 461(a) of the Code, which addresses timing, states that the amount of any deduction shall be taken in the taxable year that is the proper taxable year under the method of accounting used by the taxpayer in computing taxable income. Additionally, section 1.461-1(a)(2) of the Income Tax Regulations provides that an accrual method taxpayer may deduct an expense in the taxable year in which all events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability.

Section 461(h)(1) of the Code provides that in determining whether an amount has been incurred with respect to any item during any taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such item occurs. The Code goes on, in part, to further clarify in section 461(h)(2)(C) that if the liability of the taxpayer requires a payment to another person and arises out of any tort, economic performance occurs as the payments to such person are made.

Section 1.468B-3(c)(1) of the Income Tax Regulations provides that for purposes of section 461(h), economic performance occurs with respect to a liability described in

section 1.468B-1(c)(2) (determined with regard to sections 1.468B-1(f) and (g)) to the extent the transferor makes a transfer to a qualified settlement fund to resolve or satisfy the liability.

Section 1.468B-3(d) of the Income Tax Regulations provides, however, that “[n]o deduction is allowed to a transferor for a transfer to a qualified settlement fund to the extent the transferred amounts represent amounts received from the settlement of an insurance claim and are excludable from gross income.”

Section 1.468B-3(b)(1) of the Income Tax Regulations provides that a “transferor must obtain a qualified appraisal to support a loss or deduction it claims with respect to a transfer to a qualified settlement fund of” nonpublicly traded securities issued by the transferor.

In this case, Company transferred to Trust 100% of its stock, proceeds from its products liability insurance policies, all of its M related rights or causes of action that it has or might have in the future against other entities, and excess cash not needed to operate Company so that Trust may resolve Company’s M-related liabilities.

CONCLUSIONS

Based solely on the information provided and the representations made, we conclude as follows:

- (1) The Trust will constitute a qualified settlement fund under section 1.468B-1(c) of the Income Tax Regulations. The Trust will be treated as a separate taxable entity.
- (2) The Trust will be subject to tax on its modified gross income as defined in section 1.468B-2(b) of the Income Tax Regulations at a rate equal to the maximum rate in effect for that taxable year under section 1(e) of the Internal Revenue Code.
- (3) The transfer of the Company stock into the Trust and the transfer of cash and other assets into the Trust on behalf of the Company to resolve the liability that the Trust was created to assume, will not constitute gross income to the Trust.
- (4) Company, generally, will be entitled to deduct transfers made to the Trust, in the year of each payment. It will not be able to deduct any transfers to the Trust, to the extent that they represent settlements from insurance claims that are excludable from gross income as described in section 1.468B-3(d) of the Income Tax Regulations. No opinion is expressed as to the value of the stock transferred to the fund. Additionally, no opinion is expressed regarding the value of the assignment of rights to proceeds of asbestos related claims or causes of action Company might have had against other entities. Assuming, without deciding, that Company must recognize gross income by reason of the transfer of funds from its liability insurance carriers to the Trust, Company

would be allowed an offsetting deduction under section 162(a) equal to the amount of the gross income.

Except as specifically ruled above, no opinion is expressed as to the federal tax treatment of any issue addressed in this ruling under other provisions of the Internal Revenue Code and Regulations that may be applicable.

This ruling is directed only to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file in this office, the original of this letter is being sent to you. A copy will be sent to your authorized representative.

Sincerely,
Michael D. Finley
Chief, Branch 7
Office of Assistant Chief Counsel
(Income Tax and Accounting)